HISTORY OF BANK INDONESIA : BANKING

Period from 1966-1983

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1. Highlights

The Guided Economic System was halted in the aftermath of 30 September 1965 Aborted Communist Coup that triggered a number of political changes in the mid of 1960s. Supersemar (the document for handing over the government power from Soekarno to Suharto) and the disbanding of PKI (Indonesian Communist Party) ended in the downfall of Soekarno. The Old Order changed into the New Order. The early step of the New Order began with the swearing in of the Ampera Cabinet, replacing the Dwikora Cabinet. The Ampera Cabinet main task was to implement the stabilization and rehabilitation programs, focusing on inflation control, sufficing needs for food and clothes, rehabilitating economic infrastructure, and improving exports. In general, economic and national development was the New Order first priority to improve Indonesia's future. Bank Indonesia and the national banking system played a strategic and vital role in supporting the national economic development. Therefore, the restructuring of Bank Indonesia and the banking system were also the priority of the New Order's preliminary steps.

The restructuring of the banking system was done through Act No. 14 1967 dated 30 December 1967 concerning Banking Principles, while the restructuring of Bank Indonesia was through Act No. 13 of 1968 dated 7 December 1968 concerning the sole bank. Then the sole bank or Bank Negara Indonesia established in 1965 was split again into its original status. The state banks of the time comprised the Central Bank (BI), BNI 1946, Bank Bumi Daya, BTN, BRI, Bank Ekspor Impor Indonesia, and Bank Dagang Negara, which was previously not grouped in the sole bank. Prior to the issuance of Banking Act of 1967, the Banking Conference Council (BMP) was established to assist the government in formulating regulations of establishing banks, rule concepts of new clearing, and deliberations in settling civil cases in banking.

In the early period of the New Order, the condition of the national private banking was in misery. This was, among other things, resulted from too many private banks up to mid 1971 while most of them were small banks with small capital and poor management. In the period from 1971 – 1972, government-backed BI carried out Policy Program of Controlling National Private Banks with the objective of cutting down the number of national private banks and to strengthen those who wished to stay in business. Such control was focused on the two main efforts, namely the halting of new bank permit issuance and simplifying the number of banks by merging them through reward and enforcement. The action succeeded in significantly downsizing the number of banks from 129 in late 1971 to just 77 in 1980.

In increasing the mobility of public funds, BI introduced TABANAS (National Savings) and TASKA in 1970 that completed the Presidential Instruction of 1968 on Deposits. The three programs were blanket guaranteed by BI. BI also provided huge funds through Bank Indonesia Liquidity Credit (KLBI) extended to the seven state banks to finance credit programs as to mobilize public funds. KLBI program was even intensified with the encouraging of small

enterprises, such as KIK/KMKP (credits for small industries), Investment Credit and Credit for Indonesian University Students. Through this step, BI had taken over the position as the largest fund supplier for the country’s economy through its relatively low interest rates. As a complimentary component in financing economy, non-bank financial institutions were needed. For that purpose, in 1972 BI initiated the establishment of 12 Non-Bank Financial Institutions (LKBB) of development type and another 10 LKBB of investment type. BI and the Ministry of Finance also formed venture capital companies to support the financing of several different economic sectors. It was during this period that for the first time in the country’s banking history that banks were given the ratings of being sound, moderate, and unsound. The assessment rules of bank soundness level in 1975 adopted the penalty points system, also known as “Soundness Level of Problem Value” that withstood for 16 years until 1991.

As from 1975, Indonesian banking industry had become an industry of which its activities were all regulated by the Government and BI. None of the banks had to be particularly supervised because they were problematic and faced liquidation. Statistically, the number of banks remained unchanged for years during this period. The stable banking condition due to the tight regulations drove banks to be less initiative. Constructive competitions did not surface and banking transactions principles were conducted so traditionally for years that the banking products offered did not vary nor improve.

2. Direction of Banking Policies 1966-1983

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Furthermore, the state-owned banks were given their respective missions to cater to certain economic sectors in compliance to the respective act of the banks. In the next step, the banks were encouraged to step up their public fund mobilization to support the development financing, and simultaneously ease the Government's burden. For this purpose, the Government launched the national saving drive. The Government deliberately created two types of saving, namely the National Development Deposit (TABANAS) and Time Insurance Deposit (TASKA).

The economic financing by the banking sector was directed to support the food procurement program, while the government decided to ban the long-term credit and import financing. This move was aimed to fight hyperinflation carried over from the period before this.

The other business activities included in the banking financing priority were textile industry and home craftsmanship. These priority economic sectors received subsidized soft loans called the program credit. Accordingly, BI Indonesia extended Liquidity Credit known as KLBI for the banks disbursing the program credit.

To provide the banking service access to more people, the suspension of bank establishment licenses, including the branch office opening in 1959 were lifted in 1966. The licenses for branch office opening was granted by the Minister of Finance upon a recommendation from Bank Indonesia. Again the licenses were suspended from 1967 until 1968 following the bank crisis in 1967. The crisis was sparked by the sheer amount of bad debts due to the deteriorating economic condition and hyperinflation. This prompted the suspension of 21 banks from clearing participation. Furthermore in 1969, the license suspension was lifted. The main prerequisites to establish a new bank were as follows:

1. capital adequacy ratio to correspond with the city where the bank is seated;
2. the place of the bank establishment still requires a bank and;
3. the corporate entity must have a limited liability company status;
4. all the shareholders and board members are Indonesian citizens.

In short, the bank supervision role in this period was focused on empowering the banks as the agents of development to ensure enough supply of food, clothing and people's economic development.

3. Strategic Steps 1966-1983

Upon the enactment of Act No. 13 of 1967 dated 20 September 1967 on Banking, which was followed with Act No. 13 of 1968 dated 7 December 1968 concerning the Central Bank, the Sole Bank system/Bank Negara Indonesia as the central bank was revoked. This bank which was a merger of Bank Tabungan Negara and other state commercial banks, with exception of Bank Dagang Negara, with Bank Indonesia. By doing so, the discrepancy was ended.

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In correspond to the revamping of the banking system and in accordance with the transparency principles adopted by the Government, the establishment of banks and branches of national private banks were opened again in July 1966. As a result of the shifting of license granting authority from the Minister for Bank Scrutinizing Affairs and Minister for Central Bak Affairs to the Minister of Finance as well as the temporary banning of new bank establishments, in January 1969, the ban was lifted and the incorporation of new banks were subject to new terms and conditions. Foreign banks were permitted as of May 1967, and accordingly, the Minister of Finance granted the licenses to 10 foreign banks to operate in Indonesia and one joint venture bank. At that time, foreign banks were allowed to only operate in Jakarta.

To cope with the banking crisis that hit Indonesia in 1967, BI imposed some scrutiny measures against a number of banks which had performed unsound banking practices. These scrutiny measures against the national private banks comprised strict control and their suspension from clearing activities. However, such scrutiny measures which were followed by extending emergency funds to the banks were subject to clearing suspension and the banks which were short of liquidity. This step was taken to prevent the problem from spreading to the other banks, as well as to overcome the liquidity pressure. The managements of the banks were encouraged to immediately raise their liquidity level. To complement this scrutiny measures, the central bank issued technical, operational, and bank business supervision guidelines to the boards of commissioners of the national private banks to exert their role against the banks they were overseeing. In addition, Bank Indonesia prohibited inappropriate joint schemes within the banks which had caused erosion of the public confidence in the national private banks.

To enable the national private banks participate and develop the people’s potentials and innovation in the economic sector, Bank Indonesia gave the opportunity for the qualified national private banks to act as foreign exchange banks.

The scrutiny measures against the state banks were taken by stepping up the efficiency of their branch office network. Further, the opening of branch offices of state banks had to obtained the permission from the Minister of Finance upon the recommendation from BI. In addition, BI cooperated with Indonesian Police Force (AKRI) and the Attorney General office to establish the Special Inspection Team for Bank Negara Indonesia (TPC). The team was responsible for inspecting and investigating all state bank officers against any alleged embezzlement or fraud, and bringing the case to the court. In its further development, the duties of TPC were expanded to cover private banks and regional development banks.

During a conference convened on 19 August 1967 which was attended by the representatives from the central bank, state banks, Jakarta Development Bank on behalf of the regional banks across Indonesia, and the Association of National Private Banks (Perbanas) on behalf of all national private banks, the participants agreed to set up a banking forum called the Banking Consultative Board (BMP). This forum was responsible for creating a sound and orderly banking system to help the Government cope with economic and monetary affairs. One of BMP's recommendations, which BI later executed, was asking all banks to announce their condensed financial statements on a regular basis. By doing so, the public had the access to know their business progress. These financial statements had to be published in one of the local newspapers and pointed out the banks' quarterly progress.

Based on the reviews and observation by BI of the banking development until 1969, it was concluded that the country required a policy to further restore its banking system, in particular the private banks. In response to this; in November 1969, BI made an outline of the banking restoration system. The first move was to give a flexibility to all banks in meeting their obligations as to maintain their mandatory current accounts in BI, and maintain their cash ratio so that the banks were able to manage their liquidity in a more flexible way. BI provided free consulting service for the national private banks to find a way out from the problems they were facing. In addition, BI provided secondary reserves facility to ensure efficient bank fund mobility, and liquidity credit for the banks to expand their businesses on the condition that they had been adopting sound business practices. This facility was made available while advising the banks to use their manpower and capital more efficiently through a merger, for example. To stimulate the banks to prefer a merger, BI and the Government offered various incentives and temporarily banned the establishment of new banks and opening of new branch offices. BI also expanded the disbursement if KLBI to the national private commercial banks. KLBI which was initially restricted to cope with the bank runs as some banks had been prevented from clearing participation in 1967, was expanded to three purposes. Meanwhile, the General Emergency Liquidity Loans could be disbursed to the banks experiencing liquidity shortage prompted by force majeure conditions, such as the government's monetary move. Special Emergency Liquidity Loans were available for banks inflicted with unexpected events, while Re-pledged Liquidity Loans were extended to expand credit disbursement by the national private banks for all sectors with exception of import for the banks meeting the sound bank practices. Upon the enactment of the regulations on the procedure for assessing the banks' soundness, the maximum amount of KLBI disbursable to the national private banks were limited according to their level of soundness and ownership factor of the respective banks.

To recapitalize state banks which were short of funding sparked by the increasing business volume and various risks which emerged, BI provided liquidity credit which

was frozen and recorded in the respective banks. While, the state banks were given technical assistance coupled with the guidelines from foreign banking experts from Canada. The experts were here to compile a manual for the bank operations, bank lending, international business, personnel, administration, internal control and management.

To the regional development banks, BI extended liquidity loans under the same scheme as that extended to the private national banks. In addition, BI, offered technical assistance in compiling the manual and employee training and education.

To expand the bank lending by the secondary banks made up of rural banks, small trader banks, and other similar banks, BI offered liquidity loan facilities to these types of banks. These loans were disbursed via Bank Rakyat Indonesia. These secondary banks were from 1982 officially called Bank Perkreditan Rakyat.

In 1975, BI coined a method to assess the development of a bank, viewed from many aspects, simultaneously to assess its level of soundness. By setting the criteria to determine the soundness of a bank, it was expected that the management of the said bank was able to identify the level of soundness of the bank they were running. The management was able to address the aspects worth correcting. The principles of bank soundness level assessment were based on two factors, namely the bank's financial condition and working system.

As the Indonesian capital market began to grow, BI encouraged bank recapitalization by offering their shares to the public. In respect to this, BI set the requirements for the national private commercial banks that wished to sell their shares through the capital market, apart from the prerequisites from the Capital Market Supervising Agency (Bapepam).

Some innovative steps were taken by BI to support the country's economic growth. In 1969, BI, using the instruments and its authorities, extended liquidity loans to the bank, particularly state banks for further disbursement to the sectors considered priority by the Government. This step aimed to ensure there was enough supply of food, as well as to empower the cooperatives in supplying foodstuff. The liquidity loans, that had been disbursed since 1969, was increased in 1973; thanks to the oil boom which Indonesia enjoyed from 1974 until 1978. From that year, BI's policy was extending subsidized selective loans to speed up the banking credit growth. The goal of this policy was to spur the development and equal distribution of wealth by developing small enterprises.

4. Supervision Authority 1966-1983

On 15 December 1966, the Minister for the Economy and Finance announced that the Ampera Cabinet no longer had Minister for the Central Bank Affairs (MUBS) and the Minister for the Bank and Private Capital Control (MUPBMS). As a result, the applications for establishing new banks and closing banks and branch offices had to be submitted to the Minister of Finance.

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On 30 December 1970, Act No. 14 of 1967 concerning the Banking principles was passed. This act annulled the provision which regulated the former banking system, namely Government Regulation No. 1 of 1955 on the Supervision of Credit Affairs. The act stated that the establishment of state banks had to comply to the act, while the opening of branch offices and representative offices had to first obtain a permit from the Minister upon the recommendation from BI. For non-state banks, their establishment and opening of branch or representative offices had to obtain the licenses from the Minister of Finance upon a recommendation from BI.

The duties of BI in supervising and developing the banks were also regulated under the Act on Banking Principles of 1967, in particular article 30 to article 35. These articles covered the duties of BI to draw regulations, supervise, inspect, develop and impose penalties over the breach of obligations that have to be fulfilled by banks.

As the next efforts to control the secondary banks which comprised rural banks, small traders banks and other similar banks, and in respect to the amendment of the prevailing act, from September 1977, BI gradually shifted its supervision and development of these banks to Bank Rakyat Indonesia (BRI). However, BI maintained its duty to stipulate the general policies. The implementation of the bank supervision by Bank Rakyat Indonesia covered, among others: finance, ownership, management and working system as directed by BI.

In respect to the capital market development in this period, the supervision of the banks with public-listed status was coordination in nature. In this way, the banking institutions were supervised by BI and the Capital Market Supervising Agency (Bapepam) as well as by the State Audit Agencies (BPK/BPKP) for the state banks.

5. Strategic Goals 1966-1983

The banking policies adopted by the new government which embraced the market-oriented economic principles were intended to ensure appropriate competition among the banks.

The banking policies adopted by the new government which embraced the market-oriented economic principles were intended to ensure appropriate competition among the banks. As a result, the policies for the national private banks were focused on lifting the bank permit suspension to pave the way of the establishment of new private national banks and control the business of these banks.

Meanwhile, to make sure that the state banks were able to act more appropriately and free from their attachment to the Sole Bank, in 1966 the Government stipulated that the units of Bank Negara Indonesia and BDN ran their business as contained in the former act on the establishment of the respective banks. Pending the issuance of such act, the Deputy Minister for Central Bank Affaire/Governor of Bank Negara Indonesia exerted some control and efforts to improve the structure's efficiency of state banks.

Meanwhile, the Capital Market Supervising Agency (Bapepam) as the supervision institution of banks had to make sure that these banks are operating without harming the public shareholders. While the supervision role the state audit agencies (BPK/BPKP) was to make sure that state-owned banks and regional development banks operate soundly that they did not harm the capital investment by the central government and regional governments.